



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Number: **201142029**  
Release Date: 10/21/2011

Date: July 26, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.33-00

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038 (CG) (11-2005)  
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner  
Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: June 6, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

**B** = State  
**C** = Date  
**D** = Governing Body Member  
**E** = Governing Body Member  
**F** = Governing Body Member  
**G** = Governing Body Member  
**H** = Governing Body Member  
**J** = Governing Body Member  
**K** = For-Profit Entity  
**L** = For-Profit Entity  
**M** = Trust

**UIL:**

501.33-00

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

**Issues**

1. Are you operated exclusively for charitable, religious, or educational purposes, where no part of your net earnings inure to the benefit of private shareholders or individuals? No, for the reasons described below.
2. Are your activities exclusively charitable, religious, or educational and conducted in a manner that is not commercial in nature? No, for the reasons described below.

Letter 4036(CG) (11-2005)  
Catalog Number 47630W

### **Facts**

You were incorporated in the state of B on C. According to your Articles of Incorporation, you are organized and operated exclusively for charitable purposes. More specifically, your purpose is to foster a change in the behavior and lifestyle habits, using education and a holistic wellness system to bring about a positive change in health for people at risk, including seniors, young people, families, women and those who are disabled.

Your governing body consists of five individuals: D, E, G, H, and J. All five members have a financial interest in the activities conducted by your organization. D is the Board Chair and CEO, and receives an annual salary for his duties as CEO. He is currently the managing director of K, a Limited Liability Company that provides advisory services. D's wife, E, is the Vice- Chairperson. She is a Licensed Esthetician and is the manager and owner of L, a for-profit business. G is your Secretary/Treasurer and is a Certified Massage Therapist. She currently performs her services as a contractor of L. H is a director on your governing body and is an expert in fitness and health. He is a personal trainer and has 20 years of experience in owning and operating for-profit health clubs. J is also a director and is a Licensed Chiropractor.

To fulfill your purposes, you plan to construct and operate a facility that will house health and wellness programs and services. The business hours of the facility will be weekdays from 8:30 AM to 5:30 PM. You stated in part that you are "...assembling a core group of full and part time natural health practitioners (and their equipment) in one location...". Your full-time offerings will include: Chiropractic care, Exercise Physiology, Massage Therapy, Nutrition, and Skin and Body Treatments. Each of these full-time services will be conducted by the corresponding governing body member who is licensed and certified to perform these services. The board members will basically conduct their own for-profit businesses out of your facility and pay rent to you for the space they use. You will also have other part time practitioners offering services such as yoga, acupuncture, meditation, etc. The part time practitioners have yet to be identified.

You explained that your facility will provide services to both "for-profit" and "non-profit" customers. You defined "for-profit customers" as individuals that can afford to pay market rates, and "non-profit customers" as those less fortunate. You estimate that each of your practitioners (the licensed health care professional, chiropractor, massage therapist and esthetician) will spend 67 % of their time on their own for-profit clients and 33% of their time on non-profit clients arranged by your outreach program.

Although you have not determined exact fees that will be charged for services, you did explain how your fee structure will be set up and how billing will be conducted. "For-profit customers" will pay regular market rates. They will receive services from an individual practitioner and then be billed at market rate directly from the practitioner. "Non-profit customers" will be pre-qualified by you. They will then receive services from the individual practitioner. The practitioners have a discounted rate for "non-profit customers" that is 33% less than the market rate. The practitioner will bill the customer's insurance company. Any amount not covered by the insurance company or paid for by donors on a clients behalf (explained later), will be billed to you. Then, you will subsidize the service and pay the difference. You provided the following example to explain the fees:

If a practitioner charges \$ 75.00/hour (market rate) for one-on-one counseling, you will establish a non-profit rate discounted by 33%, or \$ 50.00/hour. If the client cannot afford that rate, you will subsidize them. If the market rate for a comprehensive health evaluation is \$ 600, you will establish a non-profit rate of \$ 400. If the client cannot afford that rate, you will subsidize them.

You hope to match low-income clients with high income client sponsors, who will donate for a specific individual client or a targeted group of clients (for example, pregnant women, special needs individuals, teenagers or elderly). These donors would provide funding before your subsidy program would be used as a payment method.

In general, to qualify for the non-profit rate, the countable assets level must be less than \$2,000 for an individual and less than \$3,000 for a couple [exclusive of the primary home, one vehicle, household goods and personal belongings]. Monthly income must be less than \$1,133/mo. for an individual and less than \$1,525/mo. for a couple.

You will also have programs aimed at healthy physical and mental wellbeing. You will maintain a resource and education center at your facility. In the resource and education center, you intend to offer interactive educational workshops, information and referral to community medical services, and a resource library including books, magazines, health newsletters, video and audio tapes as well as web access to many traditional and holistic health wellness resources.

Educational sessions will be offered and implemented by your staff and will take place in the "all purpose room". These sessions will take place before or after normal business hours. You hope to offer at least three educational offerings each week.

In addition to providing services and information, you will sell nutritional and wellness products at your facility. Natural food and produce, vitamins, herbs, supplements, water products (and equipment), books, weight management and recycled products will be sold. For this endeavor, you plan to provide and sell the products to "for-profit customers" at fair market value and to "non-profit customers" at cost.

Sales of merchandise and products will occur in the lobby and waiting room areas of your facility. They will be sold on your behalf by all practitioners and participants. Merchandise and products will be available for sale during normal business hours. Individual practitioners will not be allowed to sell their own products or merchandise in common areas of your facility.

According to your financial information, in the first two years, you expect donations to be your main source of income while your facility is being constructed. Then, in the third year, your main support will come from selling products and services and renting space. Rental receipts will be collected from the practitioners. The rest of the program income will come from retail sales of nutritional/wellness products, wellness evaluations and one-on-one coaching/mentoring.

Currently, trust fund M is the owner of the property upon which you plan to build your facility. If you can raise the money needed for construction of the building, the land would either be donated to you or you would purchase it from M at fair market value. If funding cannot be

obtained to finance the construction of the building and private financing has to be arranged, the building will be privately owned. In this scenario, all participants (including you) would pay their pro rata share of rent to the owners of the building.

All rooms will be provided on a rental basis. You report that the fair market rental rate in your local area is \$ 1/sq. ft. You plan to base the rental rates on the amount of space used and the market rate for that space. Part time practitioners will be billed an occupancy charge on a per day (or per hour) basis at market rate.

When asked about the role of K in your operations, you indicated that they are currently inactive pending your startup. However, it is not anticipated that they will be providing services to you. If any transactions do occur, they will comply with your current conflict of interest policy.

### Law

IRC section 501(c)(3) provides for the recognition of exemption of organizations that are organized and operated exclusively for charitable, religious or educational purposes, where no part of the net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Federal Tax Regulations states that in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the Federal Tax Regulations states that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Federal Tax Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

Revenue Ruling 98-15, 1998-12, IRB 6, applied the definition of "charitable" as noted in Income Tax Regulation 1.501(c)(3)-1(d)(2) and stated that not every activity that promotes health supports tax exemption under §501(c)(3). For example, selling prescription pharmaceuticals certainly promotes health, but pharmacies cannot qualify for recognition of exemption under section 501(c)(3) of the Code on that basis alone. Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980) ("Federation Pharmacy"). Furthermore, "an institution for the promotion of health is not a charitable institution if it is privately owned and is run for the profit of the owners." 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* §372.1 (4th Ed. 1989). [See also *Restatement (Second) of Trusts*, §376 (1959)].

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), a non-profit hospital with an independent board of directors executed a contract with a medical partnership composed of seven physicians. The contract gave the physicians control over care of the hospital's patients and the stream of income generated by the patients while also guaranteeing the physicians thousands of dollars in payment for various supervisory activities. The court held that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

The petitioner in est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), conducted training, seminars and lectures in the area of intrapersonal awareness. Such activities were conducted under licensing arrangements with various for-profit corporations. The licensing agreements were conditioned on the petitioner maintaining tax exempt status. The petitioner argued that it had no commercial purpose of its own and that its payments to the for-profits were just ordinary and necessary business expenses. The Court did not agree with the petitioner citing that the operational test (see Section 1.501(c)(3)-1(c)(1) (1) of the Income Tax Regulations) focuses on the purpose rather than nature of an organization's activities. The Court concluded that the petitioner is not exempt under section 501(c)(3) of the Code because the petitioner serves a substantial private and commercial purpose rather than an exempt purpose.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989), the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of a nonprofit corporation that conducted continuing medical education tours. The petitioner had three trustees. Mr. Helin, who was a shareholder and the president of H & C Tours, a for profit travel agency. Mr. Regan, an attorney, and a third director who was ill and did not participate. Mr. Helin served as executive director. The petitioner used H & C Tours exclusively for all travel arrangements. There is no evidence that the petitioner ever sought a competitive bid. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded that:

When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) even if it furthers other exempt purposes.

### **Application of Law**

You are not described in section 501(c)(3) of the Code because you are not operated exclusively for religious, charitable, or other purposes specified in the statute, and your net earnings inure to the benefit of private individuals.

Although you meet the organizational test, you do not satisfy the requirements of section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you do not meet the operational test.

You are not "operated exclusively for one or more exempt purposes" as set forth in section 1.501(c)(3)-1(c)(2) of the regulations because your net earnings inure to the benefit of the

members of your governing body. Your activities provide the individual practitioners practicing in your facility with increased clientele and revenue that they would not receive were it not for your services and activities. This is evidenced by the fact that 33% of their clients will be "non-profit" clients pre-qualified by you and who would normally be unable to pay for these services. Even though the practitioners are providing the services for a reduced fee, they are still receiving substantial private benefit because of your activities. Furthermore, even your organizational structure will increase business to the related for-profit entities. It is reasonable to conclude that by bringing all of these services together under one roof, and advertising as a non-profit health and wellness center, each individual practitioner will receive more clients. Since the practitioners are also the members of your governing body, this constitutes inurement. Inurement to interested parties is strictly prohibited and precludes exemption.

You do not meet the requirements of section 1.501(c)(3)-1(d)(1)(ii) of the Federal Tax Regulations because your operations benefit the private interests of the individuals who created you.

As noted in Revenue Ruling 98-15, not all activities that promote health support tax exemption under section 501(c)(3). Institutions that are devoted to promoting health are not charitable when they are privately owned and run for the profit of the owners. Although you are not "privately owned", your facility will clearly be operated for the profit and benefit of your governing body members. This benefit constitutes inurement. Exemption cannot be granted when inurement to private individuals is present.

You are similar to the organization involved in the court case Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945) which was denied exemption. Although you do have some purposes and activities that fall within the guidelines of section 501(c)(3) of the Code, such as your educational sessions, you also have substantial non-exempt activities in the form of inurement and commerciality. Because the services that you claim are your activities are actually performed by the related for-profit entities, your primary activities include renting space in your facility to for-profit entities at a market rate and selling products to the public at market rate. Neither of these activities are exclusively charitable, educational, or religious, but rather commercial activities normally carried on for profit. As explained in the court case, the presence of a single non-exempt purpose, so long as it is substantial in nature, destroys the claim for exemption, regardless of the number or importance of any truly exempt purposes. In your case, you actually have two non-exempt purposes: inurement and commerciality.

Your educational sessions are in furtherance of educational purposes, which are exempt in nature. However, they constitute only a small portion of your overall program. Your main program is the operation of your facility, which will house the for-profit practices of the members of your governing body and other service providers. This is verified by the fact that you plan to have only three educational sessions per week and they will be conducted "before or after normal business hours." In contrast, your commercial activities that provide inurement to your board members are conducted Monday through Friday, from 8:30 AM to 5:30 PM.

You are similar to the organization in Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), which was denied exemption. Even though your purpose is the promotion of health,

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the manner in which your operations are conducted provide private benefit to the members of your governing body. When the private benefit is flowing to insiders, including governing body members, it constitutes inurement. Your activities of advertising, pre-qualifying, and subsidizing "non-profit clients" creates a whole new market segment to which your board members' for-profit entities can now provide services. In fact, you explained that 33% of their clients will be these "non-profit" clients. This is revenue they would not receive were it not for your activities. This mode of operation constitutes inurement. Again, the presence of inurement nullifies your claim for exemption under section 501(c)(3) of the Code.

You are similar to the organization in est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), which was denied exemption. As described above, your activities serve a substantial private and commercial purposes rather than an exempt purpose.

You are also similar to the organization in International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36 (1989). Like this organization you are controlled by a governing body of interested parties. You did not create an unbiased governing body and seek out qualified practitioners in an unbiased manner. Instead, it appears you are group of practitioners who came together to operate your for-profit businesses in a cooperative manner in order to increase your client bases, and therefore increase revenue. Like the organization in this court case, you have a substantial purpose of benefiting the related for-profit entities that will operate their practices out of your facility.

#### **Applicant's Position**

You provided statistics showing your area to be one in which over 20% of the population is below the poverty line.

You commented on the current healthcare system in which mostly "sick care" is provided rather than preventative services. You stated that a nonprofit, community based, integrated facility, such as what you plan, will simplify the path to wellness. You went on to indicate that many organizations pool for-profit talent to further a nonprofit cause. You intend to partner for-profits with your nonprofit to provide wellness services. This will include your practitioners plan to network with other sister groups in your area.

You mentioned that some of your governing body members (who will also be contracted for services) already have some charitable endeavors. J already conducts free physicals for twenty local Special Olympics participants and would like to expand those services. F enjoys helping underprivileged girls with low self-esteem overcome their acne skin problems. G gives therapeutic massages to physically handicapped individuals. They hope to continue these endeavors through your Center.

You also indicated that members of your governing body have ties to the Native American, Veteran and disabled communities. You hope to serve these communities by providing access to health resources.

### **Service Response to Applicant's Position**

We do not disagree that some of your activities and operations are charitable in nature. However, as explained above the inurement provided to the members of your governing body overrides any charitable aspect of your operations. Just like in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

Also, the preventative health services you claim to conduct are not actually activities of your organization. These services are provided by the related for-profit endeavors of your board members. Your actual activities consist of renting space to for-profit entities at market rates, selling products to the general public at market rates, pre-qualifying "non-profit clients" for your related for-profit entities, and providing some educational classes. As explained above, a substantial portion of these activities are commercial in nature and are normally carried on for profit.

You argue that your activities are not commercial and do not inure to the benefit of the members of your governing body. You argue that the use of for-profits is a normal necessity. However, the court cases referenced above have deemed that arrangements similar to yours, show that the private interests of insiders (including their for-profit enterprises) are substantially benefited. This benefit constitutes inurement and prevents exemption under section 501(c)(3) of the Code.

### **Conclusion**

Based on the information provided, it is clear that your net earnings inure to the benefit of the members of your governing body and their for-profit entities that conduct business in your facility. As a result, we are not able to conclude that you are operated exclusively for charitable, religious, or educational purposes, where no part of your net earnings inure to the benefit of private shareholders or individuals. We are also not able to conclude that your activities are not commercial in nature. Despite any charitable and educational purposes your activities may achieve, you do not qualify for tax exemption because more than an insubstantial part of your operations result in inurement to your board members and you operate in a commercial manner.

Accordingly, you do not qualify for exemption under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation

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during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

**Mail to:**

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

**Deliver to:**

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street  
Room 7-008  
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois Lerner  
Director, Exempt Organizations

Enclosure, Publication 892